The Development of the Transfer Pricing Process

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Opinnäytetyön päätarkoituksena oli valmistella kehitysehdotuksia Nokia Siemens Networksille siirtohinnoitteluprosessin vahvistamiseksi. Kehitysehdotukset pyydettiin tekemään mahdollisimman selkeiksi ja monipuolisiksi. Opinnäytetyön kannalta oli myös oleellista havainnollistaa, miten kehitysehdotukset vaikuttavat talousosaston prosessien vahvistumisen kautta yrityksen asiakkaisiin.

Tutkimusmenetelmäksi valittiin kvalitatiivinen toimintatutkimus. Opinnäytetyön teoriaosuuden muodostavat Suomen verolainsäädäntö, Kansainvälinen tilinpäätöskäytäntö (IFRS) ja erilaiset siirtohinnoittelumetodit. Teoriaosuuden tarkoituksena oli antaa selkeä ja johdonmukainen kuvaus siirtohinnoitteluun liittyvistä pääkohdistä lukijalle, jolla ei ole aiheesta aiempaa kokemusta.

Nokia Siemens Networksin talousosaston alla toimiva siirtohinnoittelutiimi on vastuussa siirtohintojen lisäämisestä myytäville tuotteille. Siirtohintoja tarvitaan, kun tuotteita myydään Nokia Siemens Networksin tytäryhtiöiden välillä. Toimeksiannon mukaiset kehittämisehdotukset liittyvät siirtohinnoitteluprosessin kehittämiseen. Siirtohinnoitteluprosessiin kuuluu yleinen siirtohintojen hallinnointi ja siirtohintatason maakohtainen valvonta. Toteutuessaan kehitysideat vaikuttavat siirtohintojen tehokkaampaan hallintaan ja vaikuttavat välillisesti myös toimitusprosessin nopeutumiseen. Laaditut kehitysehdotukset auttavat Nokia Siemens Networksia varautumaan uuden Motorola sopimuksen tuomiin haasteisiin ja lujittavat nykyistä järjestelmää.

Asiasanat siirtohinnoittelu, verolainsäädäntö, siirtohinnoittelumetodi, siirtohinnoitteluprosessi

Laurea University of Applied Sciences **Abstract**
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The objective of the thesis was to provide detailed suggestions for Nokia Siemens Networks for developing the transfer pricing process. The suggestions were required to be clear and detailed to display the effects of the improvements to business operations of Nokia Siemens Networks.

The qualitative occupational survey was selected as the appropriate research method for this thesis. The theoretical section of this thesis contains information about the tax legislation affecting transfer pricing in Finland, the International Financial Reporting Standards and different transfer pricing methods. The theoretical section was essential for the consistency of the thesis to provide necessary information to the reader.

Transfer pricing team is the body assigned for setting transfer prices to sellable goods in The Nokia Siemens Networks. Transfer prices are used for transferring sellable goods between different legal entities of Nokia Siemens Networks. The suggestions made according to the commission contained issues and development options related to transfer price maintenance and for maintaining the transfer pricing level on a country-specific scale. The outcome of the thesis will be used in improving the transfer pricing process. The improvement of the process ensures a more efficient transfer of sellable goods to the end customer and aids the company in preparing for the upcoming Motorola acquisition.

Keywords transfer pricing, tax legislation, International Financial Reporting Standards, transfer pricing process

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1 Introduction

1.1 Selection of the subject

Transfer pricing has gained a more significant role in the operations of international enterprises during recent years. The future presents many challenges to the taxpayer. Taxpayers are required to cope with legislation that is increasing constantly by the day across jurisdictions and is not often consistent. Revenue authorities have become much more aggressive towards transfer pricing matters. The authorities see transfer pricing as a soft target, because there is not an absolute rule for determining transfer price for any international transaction. Occasionally companies are forced to press for an early settlement and pay the demand raised by the local Revenue authority in order to avoid a lengthy and complicated court dispute. (International Transfer Pricing 2008).

In addition to evaluating the risks of tax controversies in advance, depth planning for transfer pricing also allows the group to consider implications beyond direct taxation. Planning is also essential for the reason to adequately equip business units in implementing the policy by processing inter-company transactions accurately and efficiently. (International Transfer Pricing 2008).

The planning process also provides an excellent opportunity for gathering information about the business and identifying tax and commercial opportunities that have unnoticed potential. The development of a transfer pricing policy and process involves financial, tax and operational personnel and therefore establishes an excellent opportunity for varied groups to communicate their respective positions and assess business priorities. (International Transfer Pricing 2008).

1.2 The concept of transfer pricing

In today's international market a large portion of world trade consists of the transfer of goods, intangibles and services within multinational enterprises and associated companies with business establishments in two or more countries. The right transfer pricing principle has to be applied to determine the international tax liability in each jurisdiction.

Transfer prices are the prices of goods and services provided by one part of any organization to another. This applies particularly to transactions between firms and their branches, subsidiaries or affiliates in other countries. It is possible by using suitable transfer prices to shift overall profits between different parts of the same business. This may be advantageous when tax rates and rules differ in different countries, as they invariably do. It may also be politically advantageous if profits in one country are more likely to attract criticism, or the attention of regulators, than equal profits in another. Where there is a competitive market in similar products, blatant cheating through transfer pricing can be detected, but where there are no arms-length prices for comparable transactions the determination of fair transfer prices is a real problem. (The Oxford Dictionary of Economics 2011).

1.3 Transfer pricing - a prevailing topic globally and in Finland

A large portion of the world trade is conducted by multinational enterprises and their associated companies, which increases the challenge to cope with the legislation concerning transfer pricing. To be successful in international competition a company has to have better strategy related to tax planning and transfer pricing issues than their competitors. As the business usually expands over borders of countries the importance of the international tax legislation has to be taken into account. Researches show that company specific principles related to transfer pricing issues and transactions exceeding over borders are the most significant challenges that multinational enterprises face. A survey conducted by the European Union reveals that a lack of adjustments related to transfer pricing causes double taxation for companies. (Siirtohinnoittelu, tuloverotus ja konsernistrategiat 2005).

When listing the company internationally in various countries it is important that the financial statements are in accordance with internationally applied principles. The importance of the comparability of the financial statements is highlighted when operating in securities markets; the investors require companies to provide the financial information in same format and according to the same principles to support their financial decisions. (Kansainvälinen tilinpäätöskäytäntö: IFRS-raportointi 2009).

Finland is a country popular for its technological innovations, strong economy and highly skilled workforce. During the year 2006 Finland passed a wave of legislation regarding taxation, which effects transactions going forward. The additions in the transfer pricing legislation placed Finland directly in line with its European neighbours providing greater flexibility in financing and cross border transactions. (Transfer Pricing and Transactions in Finland 2008).

"The transaction market was active in 2007 with industrial buyers re-entering the market and private equity continuing to sell to private equity. The number of transactions was at a record high, with 768 deals exceeding the previous record set in 2000, and a 17 percent increase in deals over 2006. Finnish companies purchased 105 companies abroad, whilst non-Finnish buyers purchased 101 companies from Finnish sellers." (Transfer Pricing and Transactions in Finland 2008).

With predictions of slowing economic growth and employment concerns due to ageing populations, the parliament elected in 2011 needs to streamline bureaucracy and focus on innovation to spur Finland's economic growth. (Transfer Pricing and Transactions in Finland 2008).

Efforts are required from government to develop tax and transfer pricing legislation according to international standards to encourage and increase the business conducted in Finland and abroad. In some industrialized Western countries, where most international corporations registered offices are located the necessity of sanctions for the avoidance of aggressive tax planning has been questioned. Instead it has been stated that the governments should consider tax incentives for international corporations for responsible tax conduct. For example to refrain from tax increases during transfer pricing adjustments, especially when transfer pricing related strategies, methods and relative documentation are in accordance to the OECD (Organization for Economic Co-operation and Development) transfer pricing guidelines and when the transfer pricing reporting requirements have been appropriately carried out. (Siirtohinnoittelu, tuloverotus ja konsernistrategiat 2005).

Acquisition is an essential way of carrying out industry rationalization and to seek for a new growth for a company. Within the increase in the amount of acquisitions and in the value of economical trades it is important to maintain the cost of corporate structure changes as low as possible. Tax costs caused by the break in the continuity related to the acquisition should be avoided with corporate arrangements permitted by a directive as frequently as possible. (Siirtohinnoittelu, tuloverotus ja konsernistrategiat 2005).

The changes in the objectives and principles of the group's strategic planning brings new challenges to groups, tax authorities and courts in evaluating cross-border –transactions according to tax legislation. Strategic tax planning and the related tax legislative evaluation have an essential economical impact. As the amount of preliminary court decisions currently remains low the most challenging part in transfer pricing and corporate structure changes is the common interface of these aspects. (Siirtohinnoittelu, tuloverotus ja konsernistrategiat 2005).

The recently elected parliament along with the new upcoming Finnish Council of State will have a significant impact on Finland's economic growth in the subsequent years. By setting the legislation towards entrepreneurship-friendly direction and in accordance with the international standards, the legislative bodies will ensure that international enterprises will maintain their business operations in Finland and continue to provide wealth to the nation.

1.4 The objective

The objective of the thesis is to determine the areas of improvement related to the transfer pricing process and to provide new usable information for Nokia Siemens Networks. A vast delivery of goods and services for a customer and obeisance of accounting principles and regulations is a compulsory aspect for all legal entities of Nokia Siemens Networks. Therefore, the development of the transfer pricing procedure will strengthen significantly the whole process of ordering and delivering goods between NSN and its subsidiaries.

A proper documentation of the areas which require development, is significant for Nokia Siemens Networks, because different departments inside the company can then focus on correcting the flaws in the process. The documentation is also essential for the fact that the development of some of the segments also requires collaboration with the department of Information Technology. This thesis contains detailed suggestions for strengthening the transfer pricing process as a whole by developing segments of it.

Transfer prices are set solely by using the business management software, SAP. Therefore, the IT personnel are responsible of creating and improving the transactions used in SAP. To understand the whole concept and to focus their expertise on the right aspects, the IT-personnel require clear and proper documentation related to the transactions being developed.

The transfer pricing process includes the creation of new sales items using the SAP R3 enterprise software program, general transfer price maintenance and the execution of requested price changes on country specific scale. Chapter 6.3 Transfer Price Maintenance contains more detailed information related to the transfer pricing process.

1.5 Research method

The research method applied in this thesis follows the principles of a qualitative occupational survey. A qualitative survey can be applied when the following criteria are met:

1) when focusing on aspects, which cannot be measured according to quantity
2) when the objective is to find or disclose true facts (not to fulfil existing statements)
3) when the interest aims towards on natural situations, in which all the different variables cannot be controlled
4) when the interest aims towards on individual factors of an event
5) when interested on a structure of individual factors

A Qualitative occupational survey usually includes the following aspects:

1) the objective of the qualitative action research is to simultaneously analyse and change prevalent practices
2) the research is conducted to finding answers to problems
3) people working closely on the subject of the researched criteria are also participating in the research process
4) collaboration and active working are essential aspects in addition with the actual research
(Siirtohinnoittelu: Komasin siirtohinnoitteluohjeiden luominen 2010).

2 The tax legislation affecting transfer pricing in Finland

This section of the thesis introduces the tax legislation in Finland, which defines the principles for transfer pricing. The most common transfer pricing methodologies are also explained under this section.

2.1 Required transfer pricing documentation

According to the Finnish law the transfer pricing documentation has to contain the following:

1) Description of the business
2) Description of related party relationships
3) Details of controlled transactions
4) Functional analysis
5) Comparability analysis (including information on comparables of available)
6) Description of the pricing method and its application (International Transfer Pricing 2008).

The description of business should include a general description related to the business of the taxpaying entity and the group the taxpayer belongs into. The description usually includes recent history of the group, a description of the taxpayer's position on the market, information on the business environment and the taxpayer and any information which is relevant to evaluate circumstances affecting transfer pricing. A separate government proposal concerning the transfer pricing legislation suggests to also describe the business strategy and changes made to it. The general directions also state that the business description has to be relevant to the transfer pricing of the company. (International Transfer Pricing 2008).

The description of the related parties should contain information on related parties the taxpayer has done business with during the past tax year or whose business activities affect the pricing of the transactions between the taxpayer and the related party. The information should contain reasons for the party relationships and the organisational structure of the group. (International Transfer Pricing 2008).

The document describing details of controlled transactions includes the following information related to intra group transactions:

1) type
2) parties
3) value in euro
4) contractual terms
5) relationship to other transactions with related parties ((International Transfer Pricing 2008).

The document should also include a list of relevant agreements and copies of the most important agreements. In addition, a list of cost allocation agreements, Advance Pricing Agreements (APAs), advance rulings and any rulings issued by the tax authorities to the other part of the transaction are required to be included in details of controlled transactions. (International Transfer Pricing 2008).

The purpose of the functional analysis is to analyse the transactions between related parties by also taking into account the assets and risks included. A government proposal states it is important to identify the intellectual property. The functional analysis should also contain detailed description of the so called “tested party”, a general description of the other party and characterisation of the companies. (International Transfer Pricing 2008).

The purpose of the comparability analysis is to compare the related party transactions to unrelated party transactions. The analysis is required to contain factors affecting the comparability, such as the functional analysis, the type of transferred assets and services, the terms and condition and economical factors affecting the parties. In addition, information related to the search of comparables should also be included in comparability analysis. The portion describing the search of comparables usually includes information on the selection criteria, arguments, factors affecting the comparability and adjustments made. (International Transfer Pricing 2008).

The document describing the pricing method and its application is required to include reasons for the selected pricing method and a clarification of the method being used. The clarification contains calculations used in verifying the arms length nature and details of any adjustments made. Assumptions and conclusions related to this criterion should also be included in the document. (International Transfer Pricing 2008).

Transfer pricing documentation has to reach the tax authorities within 60 days from a request. On the other hand, a taxpayer is not required to submit transfer pricing documentation earlier than six months after the end of the accounting period. For these facts the earliest due date the tax authorities could set for transfer pricing documentation is the end of June 2011. If additional information is required, the request has to be complied with within 90 days. The legislation also states that a taxpayer should monitor its transfer prices during the tax year, because it is not possible to amend the taxable income downward in the tax return when applying the Finnish tax regulations. (International Transfer Pricing 2008).

A relief from the transfer pricing documentation concerns small and medium sized enterprises. These enterprises are not required to prepare transfer pricing documentation. The definition of the small and middle-sized enterprises follows the European Commission regulations meaning that the relief applies to companies with less or no more than 50 million euro or the balance sheet less or no more than 43 million euro and less than 250 employees. Transfer pricing documentation is usually drafted in Finnish or Swedish in Finland. However, a proposal for legislation states that the documentation should also be accepted in English unless it is necessary for the purposes of the taxation to provide the documents in Finnish or Swedish. (International Transfer Pricing 2008).

The OECD Guidelines are not legally binding in Finland. However, the Guidelines are still significant in practise. Decisions of the Finnish courts do not refer to the Guidelines specifically, but the decisions are still comparable with the guidelines. Legal commentary in Finland also follows the principles of the Guidelines. (International Transfer Pricing 2008).

2.2 Tax audit procedures

The tax authorities in Finland have not revealed information related to the method they use to select a company for a transfer pricing investigation. Generally transfer pricing is just one issue in the whole concept of an ordinary tax audit. Usually the tax authorities try to audit the largest companies at a minimum of once per five years. The tax authorities can require all data, material and property which are relevant in the audit procedure. In addition, the information can also be requested from third parties, banks and investment and insurance companies. (International Transfer Pricing 2008).

The tax audit procedure usually includes a visit to the company's business premises and interviews the personnel about the issues aroused during the investigation. The taxpayer has the right to be heard during the audit process, but the right does not amount to negotiations. (International Transfer Pricing 2008). The tax authorities usually make the decision based upon the facts and assessments gathered from the taxpayer and other sources. The authorities usually present a preliminary report in which the taxpayer can include its own written response. The final report presented by the authorities may include a proposal for an adjustment (the taxpayer can also include a written response in the final report). (International Transfer Pricing 2008).

2.3 The Organization for Economic Co-operation and Development (OECD)

The Organization for Economic Co-operation and development was founded in 1961 to establish the following policies within its member countries. The policy should:

1) "achieve the highest maintainable economic growth and employment and a sustained rising standard of living in member countries"
2) "result in sound economic expansion"
3) "contribute to the expansion of world trade through a multilateral, non-discriminatory basis" (International Transfer Pricing 2008).

The tax authorities in the US and several other countries began to pay more attention to transfer pricing in the 1960s and 1970s. The OECD member countries realized that it would be useful to provide some guidance on transfer pricing to avoid the damaging effects of double taxation for international trade. The result of these actions was the OECH report on transfer pricing, which was largely based on the US experience. The Guidelines in the 1979 report were drawn up in consultation with Industrial and Trade Union Committees of the OECD and were based on the experience of experts from this field. The basic principle in the 1979 Guidelines is that the arms length prices should be used in all inter-company transactions. Nowadays, the tax authorities in most of the developed countries use the arms length principle standard for transfer pricing between related parties. (International Transfer Pricing 2008).

The arms length principle requires taxpayers to set transfer prices for any inter-company transactions as if they were unrelated entities, but all other aspects of the relationship remain unchanged. Therefore, the transfer prices should equal the price determined by reference to the interaction of unrelated firms in the marketplace. The principle is usually applied by comparing the “conditions” (price or margin) of a controlled transaction with those of independent transactions. (International Transfer Pricing 2008).

For example, a subsidiary of parent company X manufactures sport shirts and then sells the shirt to parent company x located in a foreign country, the subsidiary must asses an inter-company price (transfer price) for the shirt. When applying the arms length standard the inter-company prices should be determined by analysing how much other comparable sport shirt manufacturers receive when they sell shirts to unrelated distributors. (International Transfer Pricing 2008).

2.4 Transfer pricing methods

The Guidelines take in account various pricing methodologies according to their application. The most used methodologies are called traditional transactional methods as they are most direct. According to the guidelines the taxpayer has to select the method that provides the best estimation arm's length price. Therefore the taxpayer has to only analyze one method in depth. (International Transfer Pricing 2008).

2.4.1 Comparable uncontrolled price method

The comparable uncontrolled price (CUP) method provides the most direct way of estimating the arm's length price. The CUP method compares price charged for goods or services transferred in a comparable controlled transaction to the price charged for property or services transferred in comparable uncontrolled transaction. The OECD report suggests that CUP method should be preferred over any other methods. However, the usage of this method is often very hard to apply in practice, because multinational enterprises don't often have access to details related to third party transactions. The OECD report also suggests that multinationals and tax authorities should adapt to this method by working with data prepared for CUP purposes supplemented by other appropriate methods. The OECD has also stated every effort should be made to adjust the data in a way that it may be used approximately in CUP method. (International Transfer Pricing 2008).

The following example describes the use of the CUP method.

Far East Steel Ltd (FES) manufactures steel ingots in the Far East and ships them to related and unrelated foundry business in the UK. The ingots are identical in every aspect. In addition, the terms and conditions of the sales are also identical, except that related party customers are given payment terms of 90 days instead of the 45 given to the unrelated party customers. According to this information it is determined that the unrelated party ingot sales represent a CUP for the inter company transfer price. The difference in the payment terms must be taken into account before the actual arm's length price can be taken into consideration. Based on the existing interest rates, it is determined that the difference in the payment terms is worth 0.5 percent of the ingot price. When adjusting the unrelated party price for this difference it should be take into account that the inter-company price should reflect the unrelated party price plus 0.5 percent. (International Transfer Pricing 2008).

2.4.2 Resale price method

When using the Resale price method the arm's length price is determined by deducting an appropriate discount for the activities of the reseller from the actual resale price. The appropriate discount is the gross margin, which is expressed as percentage of net sales, earned by a reseller on the sale of property that is purchased and resold in an uncontrolled market in the relevant market. If it is possible the discount should be derived from unrelated party purchases and sales for the reseller involved in the inter-company transaction. However, if the transaction does not exist the discount may be derived from sales by other resellers and the same or similar kind of market. The OECD Guidelines admit that there are significant problems with obtaining the comparable data. For example, when there is a considerable period of time between the comparable transaction and the one reviewed under the group, the movements of the economy (foreign exchange rate, interest rate, recession or boom) generally could cause a possible distortion. (International Transfer Pricing 2008).

2.4.3 Cost plus method

The Cost plus method is usually applied in analysing activities of contract manufacturers or in determining arm's length charge for services. The Cost plus method determines the arm's length price by adding a reasonable mark-up to the cost of production. The reasonable mark-up is the percentage earned by the manufacturer on unrelated party sales that are similar to the inter-company transaction. The cost base for the comparable company and for the one under review is required to be analysed carefully to ensure that the costs to be marked up are consistently defined. Similarly in Resale price method which also uses gross margins as a basis for comparison, a careful comparative review of the account policies is as important as the determination of the mark-up. This should be done in a purpose of view to identify any possible mismatches of expense categorisation between cost of goods sold and administrative expenses when comparing the financial results of the taxpayer and the comparables. (International Transfer Pricing 2008).

When defining the specific mark-up used in contract manufacturing case, it is important to take into account that the goods transferred under the comparable transaction need to be physically similar to the goods transferred under inter-company transaction. For example, a contract manufacturer should be compensated for the providing the manufacturing service rather than for manufacturing a particular product. (International Transfer Pricing 2008).

When determining the arm's length mark-up for fully fully-fledged manufacturers the nature of the product is significant for the analysis especially if the manufacturers operate with a great degree of independence and carry out sophisticated activities. Mark-ups paid to manufacturers usually differ from one product to another, because of manufacturing intangibles that may have been developed by the fully-fledged manufacturer. Therefore, the identification of a comparable may be enormously difficult, unless the company manufactures and sells the product to unrelated companies at the same level of the market as the affiliates to which the related party sales are made. (International Transfer Pricing 2008).

3 International Financial Reporting Standards

The internalization of capital markets and enterprises resulted in a need of a generally accepted method of preparing and presenting financial statements and harmonizing financial reporting. With many different financial statements and reporting practises applied in each country around the world it is not realistic to expect that foreign investors would learn each of these individual methods. Therefore it was required to develop an international standard-setting body to prepare a method to be applied universally. (IFRS and US GAAP. A Finnish Perspective 2007).

3.1 Accounting principles

The International Accounting Standards Board (IASB) has the authority to set IFRS and provide interpretations of those standards. The International Financial Reporting Standards (IFRS) are designated to be used by profit-orientated entities. The financial statement of these entities provides information about performance, position and cash flow, which is useful for groups of users making financial decisions. These groups of users consist of shareholders, creditors, employees and the general public. The complete set of financial documents include the balance sheet, statement of comprehensive income, cash flow statement, statement of changes in equity, a description of accounting policies and notes of the financial statements. (International Financial Reporting Standards Pocket Guide 2010).

The statement of financial position (balance sheet) describes the financial position of an entity at a specific point in time. The management can use its judgement regarding the form the statement is being presented on. The management can decide whether to use a vertical or a horizontal format, which sub-classification they want to present and which information they want to disclose in the primary statement of the notes. (International Financial Reporting Standards Pocket Guide 2010).

Assets, equity, liabilities, assets and liabilities held for sale are displayed on the face of the balance sheet. Assets include property plant and equipment; investment property; intangible assets; financial assets; investments accounted for using the equity method; biological assets; deferred tax assets; current tax assets; inventories trade and other receivables; and cash equivalents. The equity section of the balance sheet consists of issued capital and reserves which are attributable to the parent owners and non-controlling interest. Liabilities are deferred tax liabilities, current tax liabilities, financial liabilities, provisions and trade and other payables. Assets and liabilities held for sale includes the total of assets held for sale and liabilities in disposal groups. Current and non-current assets and current and non-current liabilities are displayed as separate classifications in the statement unless the liquidity section contains more reliable information. (International Financial Reporting Standards Pocket Guide 2010).

The statement of comprehensive income displays the performance of an entity during a specific period of time. Entities can decide whether they want to present the statement of income in a single statement or two statements. The single-statement approach contains all items of income and expense and in addition all components of other comprehensive income sorted by their type. When using the two-statement approach all components related to loss and profit are presented in an income statement. The income statement is then followed by the statement of comprehensive income. The document in question begins with total profit or loss for the specific period and states all the components of other comprehensive income and finally ends with total comprehensive income of the period. (International Financial Reporting Standards Pocket Guide 2010).

Revenue, finance costs, share of the profit or loss (of associates and joined ventures accounted for using the equity method), tax expense, post-tax profit or loss (of the discontinued operations aggregated with any post-tax gain or loss), profit or loss of the period, other components of the comprehensive income, share of other comprehensive income (of associates and joined ventures accounted for using the equity method) and total comprehensive income are required to be included in the statement of comprehensive income. (International Financial Reporting Standards Pocket Guide 2010).

The notes to the financial statements are an essential part of the financial statements. They provide additional information related to the primary statements. The notes also include accounting policies and critical accounting statements and decisions. (International Financial Reporting Standards Pocket Guide 2010).

3.2 Accounting policies, estimates and errors

An entity follows the accounting policies defined by IFRS that are relevant to the particular circumstances of an entity. However, in some cases the standards offer a choice, because in the same situations there is no guidance available. In these cases the standards suggest the management should select appropriate accounting policies. (International Financial Reporting Standards Pocket Guide 2010).

The management uses its judgement in developing and applying an accounting policy which provides the necessary information and meets the qualitative characteristics of relevance and reliability. If there is no IFRS standard or interpretation that is applicable the management should consider the applicability of the requirements in IFRS on similar and related issues, and then the definitions, recognition criteria and measurement concepts for assets and liabilities, income and expenses in the Framework. The management may also consider the most recent pronouncements of other standard-setting bodies, other accounting literature and accepted industry practises, unless these do not conflict with IFRS. The accounting policies should be applied consistently to similar transactions and events. (International Financial Reporting Standards Pocket Guide 2010).

Standards are normally published before the required implementation date. During the intervening period in which the new or revised standard has been issued, but not yet implemented the entity discloses the fact. (International Financial Reporting Standards Pocket Guide 2010).

4 Nokia Siemens Networks

4.1 In general

This thesis is conducted at the request of the Nokia Siemens Networks B.V. group of companies (NSN). Nokia Siemens Networks is a subsidiary of Nokia Corporation and Siemens Aktiengesellschaft and it is owned equally (50%) by each of the parent companies. Nokia Siemens Networks is fully consolidated by Nokia and recorded by Siemens using the equity method of accounting. (Director’s Report and Consolidated Financial Statements 2009).

The headquarters of Nokia Siemens Networks are located in Espoo, Finland (Karaportti Campus). Despite the location of the headquarters the holding company is registered in the Hague, the Netherlands. The company has also a strong regional presence in Munich, Germany and the service business unit is located in New Delhi, India. NSN has divided its organization into three key areas: Business Solutions, Networks Systems and Global Services. This new reorganization commenced from January 1, 2010 and is designed to support business growth and to align better with the customer's needs. (Director's Report and Consolidated Financial Statements 2009).

The highest operative management body of Nokia Siemens Networks is the Executive Board, which reports to Board of Directors of the holding company. The members of the board are selected by the parent companies of NSN. Rajeev Suri was appointed as the Chief Executive Officer on October 1, 2009 replacing his predecessor Simon Beresford-Wylie. (Director's Report and Consolidated Financial Statements 2009).

Nokia Siemens Networks provides mobile and fixed network infrastructure, communications and network service platforms, along with professional services and business solutions to operators and service providers. NSN has designed a strong product and service portfolio for converging mobile and fixed infrastructure markets, customers with presence in developed and emerging markets and one of the largest service organizations in the industry. Nokia Siemens Networks has operations in more than 150 countries serving more than 600 operator customers and providing system services for over 1.5 billion subscribers. (Director's Report and Consolidated Financial Statements 2009).

4.2 Accounting Principles in NSN

Nokia Siemens Networks follows the Nokia Accounting Guidelines (principles and practice) as NSN is fully consolidated in Nokia's consolidated financial statements. Nokia's Accounting Guidelines are based on and comply with International Financial Reporting Standards (IFRS). The financial year of NSN is 1.1.-31.12. If local rules and regulations differ from the NSN principles, the local rules are applied for local statutory accounts only. The primary accounting principles for all NSN entities is IFRS accounting principles. NSN follows these rules in reporting financial information for group purposes without exceptions. (Financial Accounting and Reporting Manual 2010).

NSN accounting policies are based on the following Fundamental accounting assumptions and key accounting principles.

Fundamental accounting assumptions:

1) The basic accounting unit is the economic entity (the legal entity)
2) Business activities will continue in operation for the foreseeable future (going concern)
3) The value of money is assumed to be stable (historical cost) (Financial Accounting and Reporting Manual 2010).

Key accounting principles:

1) When determining the result of an entity on a particular period, expenses and income are allocated to the period on an accrual basis (matching). The accrual basis means that the effects of transactions and other events are recognized when they occur (not as cash is received or paid) and they are recorded and reported in the periods to they belong.
2) Provision is made for all known liabilities (expenses and losses), in which the unrealized income is not taken into account (prudence)
3) The defined accounting principles are kept unchanged from one period to another (consistency)
4) The financial statements should disclose any information which sufficiently affects evaluations or economic decisions (materiality)
5) When assessing the nature of transactions and their economic effects, the substance and financial reality of the transaction is more relevant than its legal form (substance over form)
6) It must be ensured that transactions can be verified by following the chain of entries completely (audit trail standard) (Financial Accounting and Reporting Manual 2010).

The hierarchy of standards used in basic accounting at the unit level and in Group accounting are set in the following order:

1) IFRS standards, IFRIC interpretations
2) NSN accounting principles and practise (based on IFRS standards and Nokia Accounting Principles and Standards
3) Policies and reporting instructions given by NSN local Finance & Control
4) Instructions given by organizational units
5) Laws, statutes and accounting conventions applicable in different countries (Financial Accounting and Reporting Manual 2010).

In conclusion all accounting and reporting in NSN should be based on NSN accounting principles and instructions. The local rules and preparations are only used for preparing an entity's local statutory accounts. (Financial Accounting and Reporting Manual 2010).

4.3 Accounting in different countries

During an accounting period, units of NSN must follow NSN's accounting principles in all their accounting and reporting. Rules and regulations in different countries related to financial accounting are not necessarily identical to NSN's accounting principles, therefore the local units shall also prepare financial statements in accordance with the legislation and accounting conventions followed in the country in question. If there are differences between NSN accounting policies, local legislation and accounting conventions, the NSN accounting policies should prevail in the basic accounting system. (Financial Accounting and Reporting Manual 2010).

NSN requires every unit to organize their accounting systems in a way that preparation of periodic, interim and annual reports (required by NSN group accounting) can be undertaken without problems. If local accounting guidelines in different countries leave an option for a choice, NSN recommends that the units choose the principles that are closest to NSN's accounting principles. The objective is to minimize the need for revision and reconciliation of information produced by the accounting systems of units at the reporting stage. (Financial Accounting and Reporting Manual 2010).

4.4 NSN Group Consolidation

"NSN group companies are fully consolidated in all internal transactions, internal profits, profit distributions and mutual shareholdings of Group companies are eliminated as part of the consolidation process." (Financial Accounting and Reporting Manual 2010.)

NSN accounting principles are applied to every Group unit. Each Group unit is included separately in the consolidation. Statutory sub-group accounts are prepared only when required in different countries by local legislation and accounting conventions. (Financial Accounting and Reporting Manual 2010).

5 Transfer Pricing team

5.1 In general

The Transfer Pricing team operates under Chief Financial Office, Corporate Controlling. The primary objective of the Transfer Pricing team is to ensure that the transfer pricing policy is applied in each legal entity of NSN. (Transfer Pricing process 2008).

Transfer pricing policy is the basis for all intercompany transactions and it is applied globally for the sale of goods and services. Transfer prices are also used for transferring capital and intangibles between Nokia Siemens Networks and its subsidiaries located in the countries the company operates. (Transfer Pricing process 2008).

NSN transfer pricing policy follows the guidelines of the Organisation for Economic Co-operation and Development (OECD). The policy aims to ensure fair allocation of profits between NSN legal entities in terms of risks carried, functions performed, value added and assets employed by the company. The internal dealings of NSN are performed according to the arm's length principle. The principle means that Nokia Siemens Networks must maintain the same prices and conditions internally as it would use for a third party. (Transfer Pricing process 2008).

The policy also determines that transfer prices must be used in internal transactions. Transfer prices are used for inter-company sale of equipment and are based on the resale price method. The resale method means that transfer prices are based on final net customer prices and adjusted to the price level development in the market. (Transfer Pricing process 2008).

5.2 Transfer pricing methods

Business in NSN is done either in Local mode, Split mode or Corporate Sales Mode. When applying the local mode transfer prices will be calculated so that they will leave to the local company a guaranteed Operating Profit. In the local mode customer contract for sale of services and equipment is conducted by the subsidiary (local company). Equipment is sold from the NSN Oy to the subsidiaries at transfer prices. (Transfer Pricing process 2008).

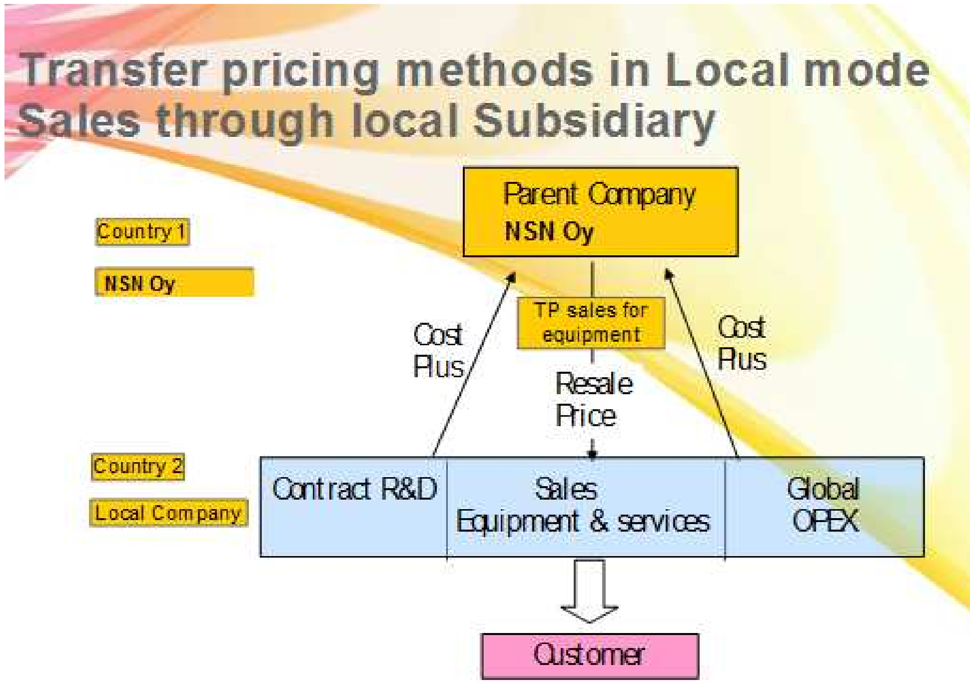


Figure 1: Local Sales mode (Work instructions for the Transfer Pricing process 2008).

In the Split mode of operation, customer contract for sales of services is done by the subsidiary, but the customer contract for sale of equipment is concluded by NSN Oy. Transfer prices are not needed for equipment sales in Split mode, because NSN Oy is selling the goods directly to the end customer with end customer prices. However, TPs are still needed in logistics systems when ordering goods using SAP system. (Transfer Pricing process 2008).

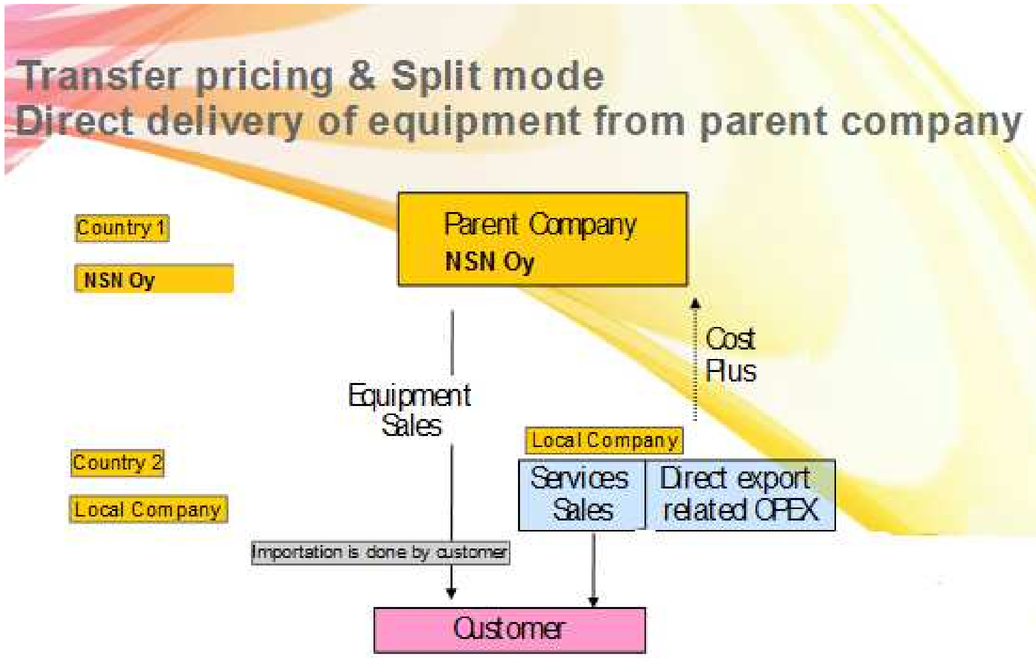


Figure 2: Split Mode (Work instructions for the Transfer Pricing process 2008).

In Corporate Sales Mode (CSM) the subsidiary 1 company (NSN Oy) handles the customer contracts and also the sale of services. In CSM mode a subsidiary provides services to the parent company on subcontracting basis. Local costs related to CSM business (both direct project costs and operating expenses) are recharged to NSN Inc. Finland with mark-up. CSM related service cost charges are instructed separately by services units. When applying the full CSM all contracts in a country are moved to the parent company and all local costs are recharged to NSN Finland. (Transfer Pricing process 2008).

There is no TP invoicing between the subsidiary and the parent company in CSM. Transfer prices are used on "proforma" invoices in deliveries to some countries outside European Union for customs declaration purposes. Proforma invoices are used as the basis for importing VAT (value added tax) payments unless the final customer prices can be used at the moment of delivery. VAT is not a final cost, but creditable against the final sales VAT. In addition, also in CSM transfer prices are required for logistics when messaging between the logistics systems (in the same way as in Split mode). Transfer Pricing process 2008).

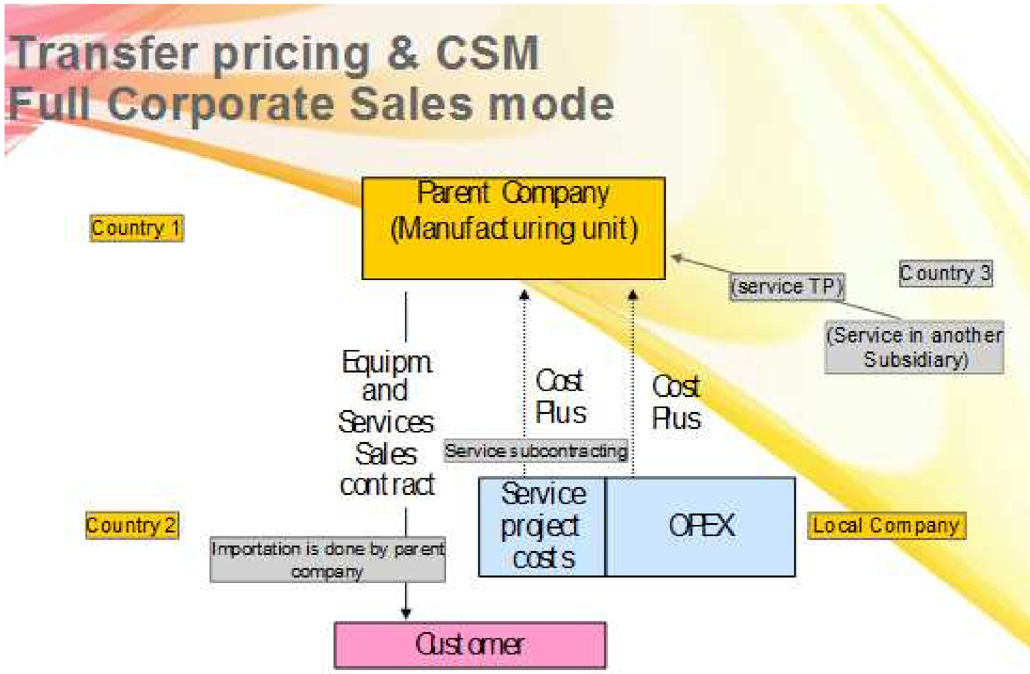


Figure 3: Corporate Sales Mode (Work instructions for the Transfer Pricing process 2008).

5.3 Transfer price maintenance

The Transfer pricing team is responsible for maintaining transfer prices in the SAP R3 environment. The Transfer pricing team calculates transfer prices for new sales item codes and updates remaining prices upon the request of a country controller. Nowadays, there are approximately 70 000 active sales items in the system and brand new items are inserted into the system daily. For the large quantity of the sales items they are divided into item groups called Global Invoicing Codes (GIC). Usually an individual GIC contains 100-500 sales items. The sales item codes under an individual GIC usually relate to each other by one or more characteristic. The codes are either hardware or software items or they might belong under the same product tree or a project. Each country NSN operates in (legal entity) has its own pricelist including the mentioned 60 000 sales items calculated in the country's own currency.

The Transfer pricing team is responsible also for maintaining the pricelists and uploading updated pricelist in NSN intranet. The pricelists are then available for local country controllers in each legal entity of NSN. The Transfer pricing team controls the transfer price level together with local country controllers. However, the Transfer pricing team is the only group of users in SAP R3 authorized to make changes to transfer prices. The objective is that the prices remain stable; therefore only necessary changes should be executed. The prices are usually changed on GIC level. This means that a single GIC is decreased or increased by a specific percentage. For example the country controller of Brazil can request the Transfer

Pricing team to decrease GIC number 5100 by -50 percent. The effect is that all sales items belonging under GIC 5100 are decreased by -50 percent. The request is always sent via mail and the mail contains also a request sheet, which provides all the necessary details for executing the change. Sometimes the country controller can also request a change on a sales item level when the price of a single sales item is tolerably high. Occasionally the Transfer Pricing team also asks permission from the local country controller to change the transfer price of a specific item. The country controller also states when the new price change will be effective. The objective is that the prices remain stable as much as possible. Therefore, the prices are set to be valid from the next period. The exception is when there is no inventory for a single sales item and on this case the price change can take effect immediately.

All price changes are documented on an Excel sheet, which contains all the price changes done within a yearly basis. The request mails for price changes are also archived on a country specific file. The purpose of the documentation is to provide information for tax officials about the total number of transfer price changes executed within a year for a specific country. Occasionally country controllers also ask why a certain price has been changed. In these cases it is simple to open the archive and provide the controller with detailed information about the change history of the specific item.

The following figure displays a section taken from pricelist of Estonia. Pricelists contain information related to the type of the sales item, under the GIC it belongs to and the current transfer price.

Cty	GIC	Material	Material Description	Matl group	Current TP
EE	2000	D1815	X220 Compact Site Doc/Paper/FI/Ne	DOCUMENT	2.364,67
EE	2000	D1816	X220 Compact Site Doc/Paper/FI/Up	DOCUMENT	1.419,15
EE	2000	D1817	X220 Compact Site Doc/Paper/EN/Ne	DOCUMENT	2.364,67
EE	2000	D1818	X220 Compact Site Doc/Paper/EN/Up	DOCUMENT	1.419,15
EE	2000	K6142	Kazan Spare Spart Set	HWARE	500.949,37
EE	2000	W1101	6 PCM Switch. Matrix Cartr. duplicate	HWARE	39.649,58
EE	2020	XL1048	ORACLE PE NSEL-A USER LTU	OEM_LIC	1,88
EE	2020	XL1056	ORACLE SEO NSEL-A CPU TS	OEM_MAINT	9.439,44
EE	4075	JNP:SRX5K-SPC-2-10-40	SEC-JUI-HW SRX5K-SPC-2-10-40	OEM_COMPP	962.866,73
EE	4075	JNP:SRX3K-SPC-1-10-40	SEC-JUI-HW SRX3K-SPC-1-10-40	OEM_COMPP	192.578,35
EE	4075	CKPIP-A-TR-10SR-S+	SEC-CKP-HW CPIP-A-TR-10SR-S+	OEM_COMPP	4.806,64
EE	4075	JNP:PAR-AR5-SRX5-FPC-IOC	SEC-JUI-SU PAR-AR5-SRX5-FPC-IOC	OEM_SERV	63.162,19

Figure 4: Pricelist of Estonia

5.3.1 Defining the correct transfer price level

Transfer prices are defined in SAP R3 for all products. Transfer prices are usually 80% of the defined copy of Internal Reference Price (IRP) values in SAP R3. When a business starts in local mode for equipment sales or when the subsidiary starts to sell some products for the first time correct transfer price level should be defined. TPs are required to be based on average net customer prices and set in place before the first deliveries start. When transfer prices are defined for the first time the country specific Finance and Control should define to the the global team how much the default transfer prices should be changed on GIC level.

It is also possible that the calculation for setting the correct transfer level is done within the global team. The following criteria have to be taken in account on this case:

- Customer price level on configuration level
- Related configurations on sales item level
- How much TPs should be lower than customer prices
- In some cases it should also be known at which level TPs should be in line with customer prices. Normally this is related to local authorities' requirements and their access to view the margin.

The Global team then calculates the correct factors to be used in SAP R3 to achieve the correct TP level. The outcome is communicated to the country controller for final confirmation.

The stricter the local rules are related to transfer prices and future price updates, the more exact information is needed as a basis for the initial setting of transfer prices. In strict cases if the configurations or customer prices change after the initial TP price setting, also those changes should be informed to avoid "unexpected" transfer prices. Correspondingly, in some cases only the average information might be enough.

Transfer prices should be set so that the specific legal entity reaches the target Operating Profit. In determining how much TPs should be lower than customer prices the Global team has to take in account the following criteria:

- Customs duties and other importation costs
- Customer discounts
- Margin for services
- Price level of other customers/products

When transfer prices are in place in SAP R3, new products thereafter simply follow the existing pricing procedure with the current factors. The defined transfer price margin is followed up regularly and the prices are updated when necessary. Adjustments are done to prices only when there is a need to ensure that the margin remains on the correct in the target country. This might happen when there are changes in the business of the subsidiary (new customers or when new contracts are introduced).

5.3.2 Reports and pricelist

Realized profitability by legal a entity is followed up regularly. The Transfer Pricing team uses special tools built for this purpose (NSN PRS and NSN NFS based TP reports) to gather the required data. In the Transfer Pricing profitability report country specific TP margin can be seen from the net sales column and the report ends with displaying the operating profit by business unit. Transfer pricing reports are published in the NSN intranet after each reporting week and communicated to Country Finance and control regularly. The objective is to analyse the actual TP margins and agree on needed actions to reach the target operating profit by the end of the year. These needed actions consist of TP changes, TP adjustments credit notes or additional invoices and recharges. Transfer Pricing team analyses the reports and makes suggestions to countries, however the country specific Finance and Control is the body who should finally know what is expected in the local business in the future and confirm the required actions.

The following figure illustrates an example of a country specific report, which is published periodically after the reporting periods in NSN intranet.

Country X	NSN Country X =one legal entity	NSN Country X
Gross Sales	16 956	16 956
Adjustements to Sales Revenue	8 748	8 748
Net Sales	**8 209**	**8 209**
Total Cost of Sales	7 852	7 852
Total Direct Costs	7 340	7 340
Total Production Overheads	512	512
Gross Margin	**357**	**357**
% Gross Margin	**4 %**	**4 %**
Total S&M Expenses	551	551
Total R&D Expenses	-114	-114
Total A&G Expenses	-873	-873
Other Operating Income/Exp.	58	58
Operating Profit	851	851
% Operating Profit	**10.37 %**	**10.37 %**

Figure 5: Report from country X

5.3.3 Ordering and delivering goods inside NSN

SAP R3 is the program used for the creation of all sales orders to provide transfer of goods between each legal entity of NSN and finally to the end customer. As mentioned earlier in the description of different sales modes, all orders are handled in SAP despite of the sales mode applied for the target country. For the purpose of logistics and for the documentation of the order history it is necessary that all orders go through SAP R3. For the quantity of the sales orders made inside Nokia Siemens Networks it is essential that there is one unique system used for processing all the orders.

For individual orders the person in logistics creates a sales order and an invoice. The next step is to select the appropriate items to be ordered and enter the sales item codes on the sales order and invoice. If all the prices are available for sales items codes inserted in the order the sales order and the invoice can be released in SAP R3. The plant where the goods have been ordered from receives the sales order and delivers the goods to the target location.

Occasionally, there are individual sales item codes which don't have a valid transfer price set. The result is that the sales order displays a pricing error for these items. The person in logistics then sends these codes to Transfer Pricing team. The TP team then runs the transfer pricing procedure to provide transfer prices for the required items. Usually the item codes, which don't have valid transfer price, are reasonably new; therefore the prices have not been inserted. The next chapter provides detailed information about the transfer pricing procedure.

5.3.4 The Transfer price creation process

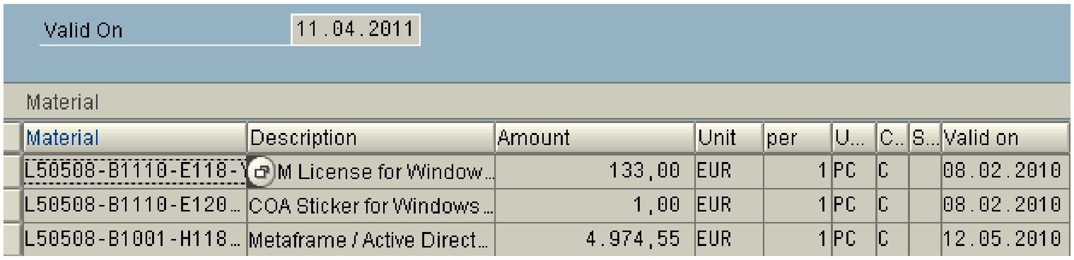
The following figure illustrates the steps required for setting a valid transfer price for each target country.

Figure 6: Pricing steps for a new item code

Transfer prices are calculated according to Internal Reference Prices (IRP), which are set by the Business Line. Personnel in the Business Line are appointed responsible for individual GIC(s). Usually IRPs are implemented in the system upon the creation of the sales item, but occasionally transfer pricing team has to request the appointed contact to set an IRP for individual item code. Transfer pricing team only calculates transfer prices for sales items, which have valid IRPs.

The first step in the process of adding transfer prices in SAP P20 environment is to ensure that an individual item has a valid Internal Reference Price. If the IRP is not available it has to be requested from the appointed GIC contact from the Business Line. The Transfer pricing team has a list of the GIC contacts. The request is sent by mail to the appointed contact who then inserts the IRP in SAP R3 P20.

The following figure displays the transaction used to verify the availability of the Internal Reference Prices in SAP R3. The material column lists the item codes and description column provides additional information related to the item code. The Internal Reference Prices are always in EUR currency. This time the IRPs are available for all three sales item codes and it is possible to proceed to the next step.



Valid On 11.04.2011

Material

Material	Description	Amount	Unit	per	U...	C...	S...	Valid on
L50508-B1110-E118-Y	M License for Window...	133,00	EUR	1	PC	C		08.02.2010
L50508-B1110-E120...	COA Sticker for Windows...	1,00	EUR	1	PC	C		08.02.2010
L50508-B1001-H118...	Metaframe / Active Direct...	4.974,55	EUR	1	PC	C		12.05.2010

Figure 7: Transaction used for the verification of the IRPs

When the IRP is available in SAP P20 the next step is to run the General List Price (GLP) program. The GLP program replicates the Internal Reference Price in Unites States Dollars (the currency has been set on 01.01.2002). When the GLP has been set for an individual item the final transfer price can be calculated.

The following figure displays the General List Price program used to calculate the USD price in SAP.

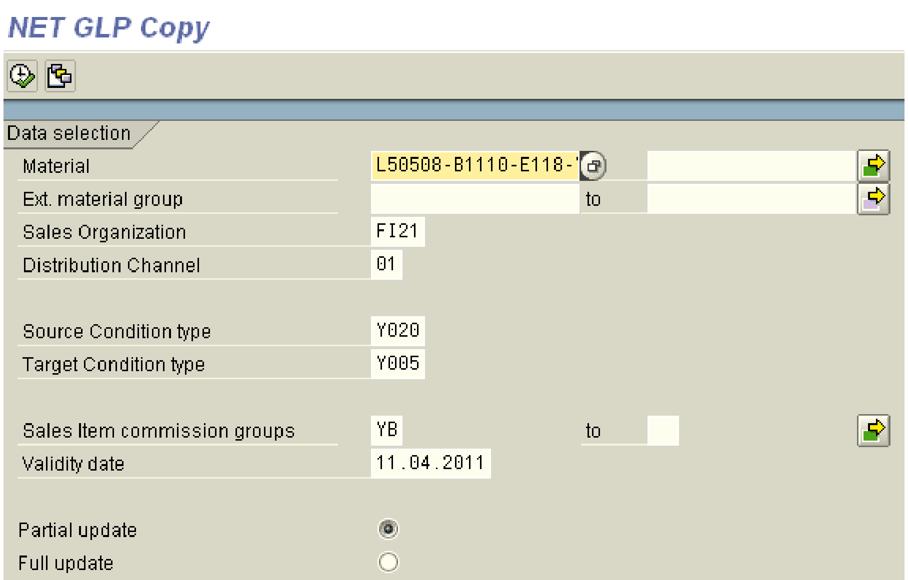


Figure 8: General List Price program

The next step following the creation of the GLP is to run the Mass calculation program to calculate the final transfer price in each country. The mass calculation program sets the transfer price in each country in the country's own currency. For example for United Kingdom the prices are calculated in United Kingdom Pounds. The formula which the program uses takes in account the General List price, attributes of the GIC the sales item belongs into and the currency of the target country.

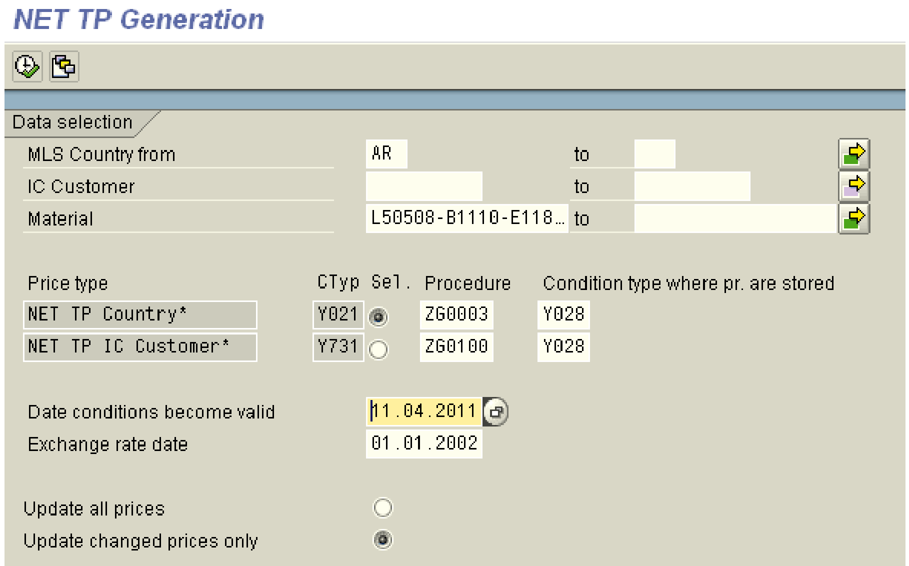


Figure 9: The Mass calculation program

The figure below revises the steps required in the transfer price creation process.

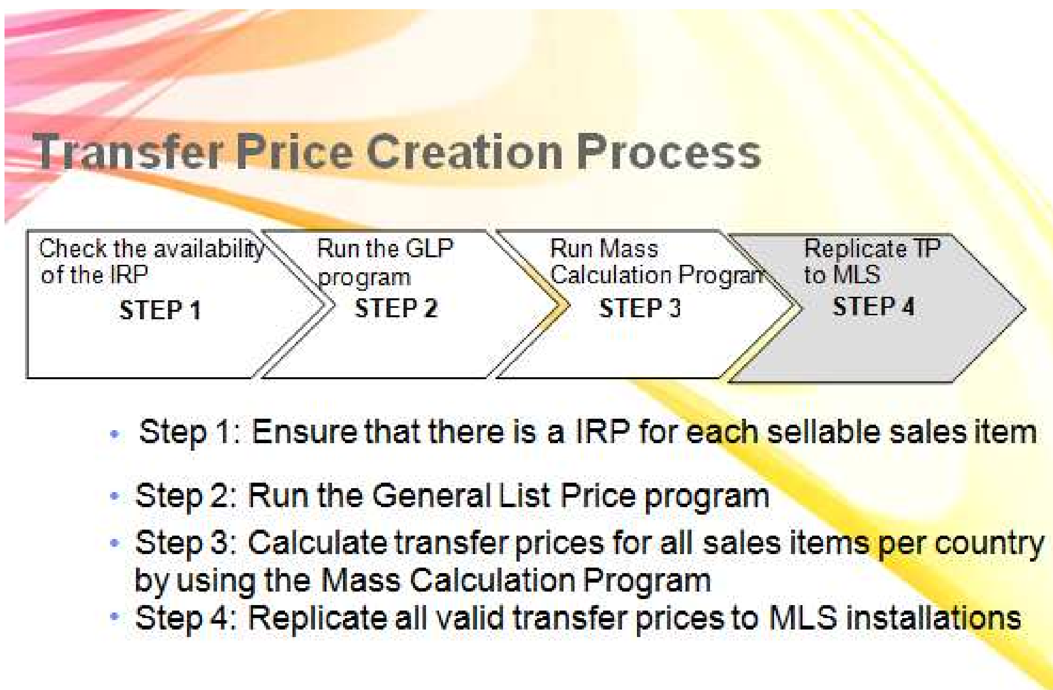


Figure 10: Transfer Price creation process

6 Current issues in the Transfer Pricing Process

6.1 The Motorola acquisition

Nokia Siemens Networks and Motorola Inc. announced on July 19^{th} 2010 that the companies have made an agreement under which Nokia Siemens Networks will acquire the majority of Motorola's wireless network infrastructure assets worth US $1.2 billion in cash. The companies are expected to complete closing activities by the end of 2011, subject to customary closing conditions including regulatory approvals. Motorola's networks infrastructure business provides products and services for wireless networks with 30 active networks in 22 countries and a robust GSM installed base, with more than 80 active networks in 66 countries. Approximately 7500 employees are expected to be transferred to Nokia Siemens Networks from Motorola's wireless network infrastructure business when the transaction has been closed. (Nokia Siemens Networks to Acquire Certain Wireless Network Infrastructure Assets of Motorola for US $1.2 Billion 2010).

The new acquisition also transfers approximately 30 000 new sales items into the SAP P20-system maintained by the Transfer pricing team. During quarterly closings (and other reporting periods) the SAP system is reasonably slow for the lack of capacity. The number of the upcoming items will severely affect the condition of the system. To avoid major difficulties during quarterly closings the SAP P20 system requires additional capacity to be able to process the large quantity of items and data.

The capacity issues are not the only challenges coming with the Motorola acquisition. The maintenance of transfer prices becomes much harder when the quantity of the sales items is increased by 30 000.

6.2 Current capacity issues effecting SAP transactions

Nokia Siemens Networks prepares its financial result periodically, quarterly and during both year halves. These times are extremely busy and many reports are run at the same time in SAP and logistics are working on final orders to be processed before the period changes. Naturally, quarters and year halves reporting periods are the busiest times and a huge quantity of data is going through SAP R3. This results in the system being pushed to its limit.

On a few recent occasions these capacity issues have caused a malfunction in the transfer pricing procedure. Either the procedure has been extremely slow or it has not worked at all. These effects have shown especially when running the General List Price or the Mass Calculation program. The programs have been running for more than two hours or have not worked at all.

It is essential from the point of view of NSN that the Transfer pricing team is able to run the required transactions. Without valid TP prices the logistics are not able to process their orders and release the invoices. This also has an effect on the customer satisfaction if the goods are not delivered on time to the appointed location. The ordered goods will not be transferred to the correct location until the sales order and the invoice has been processed in SAP. Transfer Pricing team and logistics personnel have to be able to run the required transactions and processes also during the busiest period. There have been situations where trucks have been ready to pick up the requested goods from a factory of NSN, but have been unable to deliver to the goods to the end customer due to SAP malfunction.

The simplest solution for the issue is to increase the server capacity by buying new hardware. Capacity issues are naturally handled by the IT department and require also acceptance from the head of Corporate Accounting, since the cost for the new hardware will be significant. This documentation will be used in explaining the importance of increasing the server capacity.

The General List Price copy and the Mass calculation transactions are affected the most by the current capacity issues. The lack of capacity in the server during important reporting periods is causing both transactions to take more time with processing the requested operations. After defining the required parameters (sales items, pricing dates and target countries) in the pricing procedure the program lets the user to proceed to the final phase of the transactions, which lists the target counties the prices are being transferred to and lets the user select the appropriate countries. After selecting the required countries and selecting “process in background” option the program usually halts for a long time and either finally processes the request or displays an error. If an error occurs it means that the prices were not calculated in the required countries and the transaction has to be processed again.

The following figures illustrate phase one and two of the Mass calculation transaction.

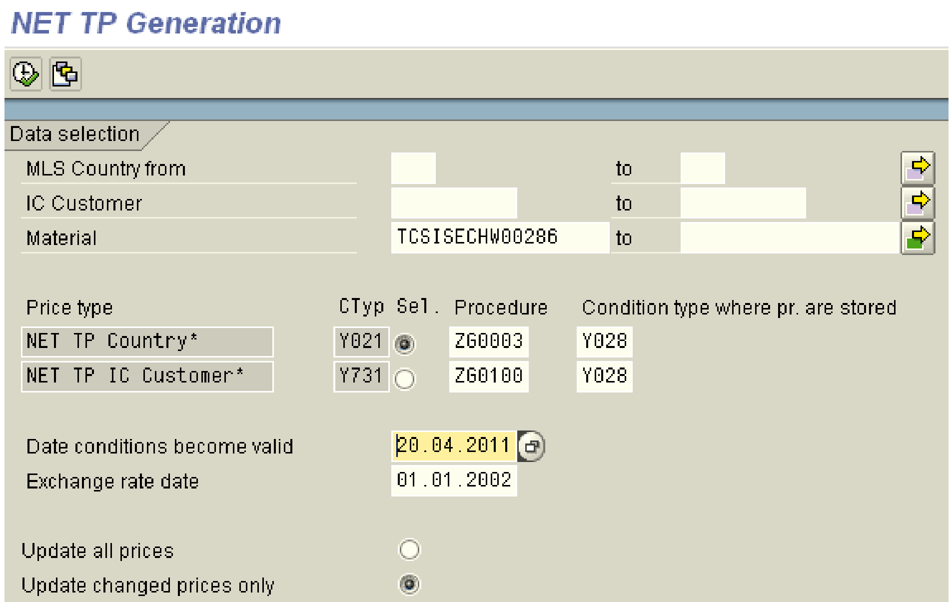
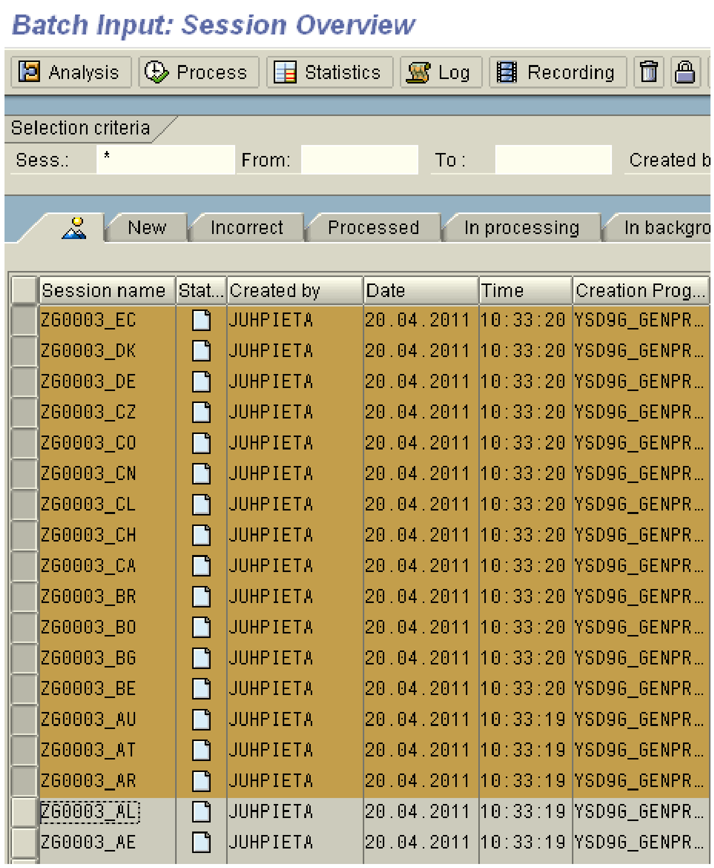


Figure 11: Phase 1 of the Mass calculation transaction



Session name	Stat...	Created by	Date	Time	Creation Prog...
ZG0003_EC		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_DK		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_DE		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_CZ		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_CO		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_CN		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_CL		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_CH		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_CA		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_BR		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_BO		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_BG		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_BE		JUHPIETA	20.04.2011	10:33:20	YSD96_GENPR...
ZG0003_AU		JUHPIETA	20.04.2011	10:33:19	YSD96_GENPR...
ZG0003_AT		JUHPIETA	20.04.2011	10:33:19	YSD96_GENPR...
ZG0003_AR		JUHPIETA	20.04.2011	10:33:19	YSD96_GENPR...
ZG0003_AL		JUHPIETA	20.04.2011	10:33:19	YSD96_GENPR...
ZG0003_AE		JUHPIETA	20.04.2011	10:33:19	YSD96_GENPR...

Figure 12: Phase two of the Mass calculation transaction

In addition to the mentioned two pricing related transactions, a transaction used for the creation of pricelists is also affected by the capacity issues. The ztpr transaction is used to provide pricelists mainly for country controllers. Pricelists are published in Excel format and uploaded to the NSN intranet. The country controllers use these pricelists to verify if the transfer prices are at the correct level with correspondence on the Operating Profit of the legal entity. There are often many last-minute changes to prices during reporting periods. Therefore it is necessary that the personnel of the Transfer Pricing team are able to provide the latest transfer price list to the appointed country controller.

6.3 GIC and sales item code simplification plan

As mentioned in the previous chapter there are more than 70 000 sales items currently in the system and 30 000 more will be added in the system after the Motorola acquisition will be legally accepted. The reasonably large number of items is currently causing not only capacity issues, but also challenges in price maintenance.

There are some inactive GICs and sales item codes currently in the system. There are also some codes that refer to the same sales item. For example, the creation of a new version for a specific software sales item code can require a new code in the system. When the older version is no longer available for order, the old item code in question will also refer to the newer version resulting in duplicate codes.

Material status describes the maturity of a specific sales item in SAP. The material status varies from Y1 to Y8. Material status Y1 is set for a new item code and usually eventually the status is set to Y8 when the life cycle of a single sales item has reached its end. Material status Y8 means that the sales item code is obsolete and is not orderable anymore. Eventually sales items with Y8 status will be completely removed from the system.

A possible option for developing the current situation is a GIC simplification plan. All GICs need to be verified to see if there are GICs which contain inactive sales items. If the whole GIC is inactive it should be removed from the system. It is also necessary to verify that are single sales items under the correct GIC. New GICs are created and sales items are transferred between different GICs on a monthly basis. In addition, also sales item codes have to be revised by checking their status and removing duplicate codes. There are many sales item codes in with wrong material status.

By reducing the quantity of sales items and GICs the whole process of maintaining transfer price would improve drastically. Revising sales items and rearranging them under a correct GIC in addition with checking the material status would also have a strong impact in developing the maintenance and the SAP R3 system could cope better with 30 000 new sales items. In conclusion, these proposals would significantly help the company to prepare for the Motorola acquisition.

6.4 Licence key items

Orderable sales items vary between service, hardware and software type. A large quantity of software items are licence key items. This means that when a subsidiary of NSN orders a licence key item the item permits the customer a right to use specific software. In the past it was sufficient only to include only one licence in the sales order. The licence then permitted the customer of NSN to use the software for the whole company. Nowadays, the policy of ordering licence items has changed. The licence key items have to be ordered according to the quantity of instalments. The change in the procedure causes a huge flaw in the system. In the past the IRPs were set tolerably high usually over 10 000 EUR and the transfer price was calculated according to the IRP. Nowadays, the orders are made by the required quantity and a person in logistics usually orders 1000 items. For example, if the transfer price for a single licence key item is 10 000 euro in the pricelist of Germany. The person in logistics then places a sales order of 1000 pieces of the requested software licence. At this point the order transaction usually halts and displays an error message which relates to the faulty price. The logistic person will then contact the transfer pricing team and ask guidance with the error.

The pricelists of each country are maintained by country controllers and if the price of a single item or GIC needs to be decreased or increased, permission from the local country controller is required. The Transfer Pricing team is responsible for executing these changes according to the directions received from the country controller. Usually when a licence key item has an invalid price the TP team requests a permission from the appointed country controller to change it to 0.01 in the local currency. After the change has been made the system accepts the new price and the sales order can be released. The price is changed to 0.01 instead of zero for the reason that the transaction used for the creation of the order does not accept zero prices.

The procedure of changing the price to 0.01 is not completely flawless. In some counties the custom legislation collides with the procedure in question. The goods being transferred could end up in the hands of customs officials and being released only after an additional tariff has been paid.

On a few occasions the transaction does not halt even though the final price of a sales order is alarmingly high. This flaw in the system has severe effects. After the sales order has been released it has a direct effect on the cost of sales of the country the goods are delivered to. For example, if a value of a single sales order is 10 000 000, after the release of the sales order the cost of sales to the destination country will show 10 000 000 surplus. In this case the whole order process has to be cancelled. This is extremely difficult if the goods have been already delivered in the destination country. The cancellation has to be done in accordance with local tax authorities and customs officials.

Action needs to be taken in order to avoid situations where adjustments are required to be made during the last minute of quarterly closing. There are different options to reduce the last minute adjustments in question. Both options include focusing the development on the beginning of the transfer price creation process.

One possibility is to make an agreement with the personnel managing the Internal Reference Prices in the business line. The agreement would include new instructions for setting prices to software licence key items. This way the IRPs would be set to close to 0.01 EUR. The IRPs cannot be set to exactly to 0.01 EUR, because some currencies are higher than EUR. SAP takes only two decimals into account, therefore the price has to be set to 0.05 for preventing the program rounding the price to 0.00 EUR. As mentioned earlier the transaction used for the creation of the sales order does not accept zero prices.

The change to 0.05 can be conducted by manually changing all the prices. This alternative would require a proper notification sent to all personnel responsible for adding new IRPs. The other option is to modify the transaction used for adding IRPs to automatically identify types of licence key items and executing the price change automatically and notifying the user about the procedure.

The other main option is to leave Internal Reference Prices untouched and focus the development to transactions used in the transfer price creation process. The modification is also possible to be implemented in the General List Price copy transaction. The modification would automatically set the General List Price to 0.05 USD despite the IRP being set.

This suggestion would also have to have the acceptance from all country controllers. Nowadays, there are 13 countries who have agreed to change the licence key items automatically to 0,01 without an additional request. The permission would need to be acquired also from the other countries, which have a pricelist of their own.

In addition to ensuring that new sales items are priced correctly, it is also necessary to revise all the current pricelists and adjust all appropriate licence key items manually to 0.01. This task will require a lot of manual work from the pricing personnel of the Transfer pricing team. However, the effects of the manual work will be dramatic and prevent unnecessary cancellation of sales orders and invoices in the same way as for new items. Unfortunately, there is no quicker way for executing the changes for the items that already have a valid price in the system.

The licence key items will be adjusted manually by using Create Net TP transaction. The transaction allows the user to adjust only 23 items in a time. This causes inconvenience for the Transfer Pricing team, because manual adjusting is really slow in case there 1000 items to be adjusted. Therefore, Transfer Pricing team has requested IT department to modify the transaction to be able to adjust larger quantity of items simultaneously.

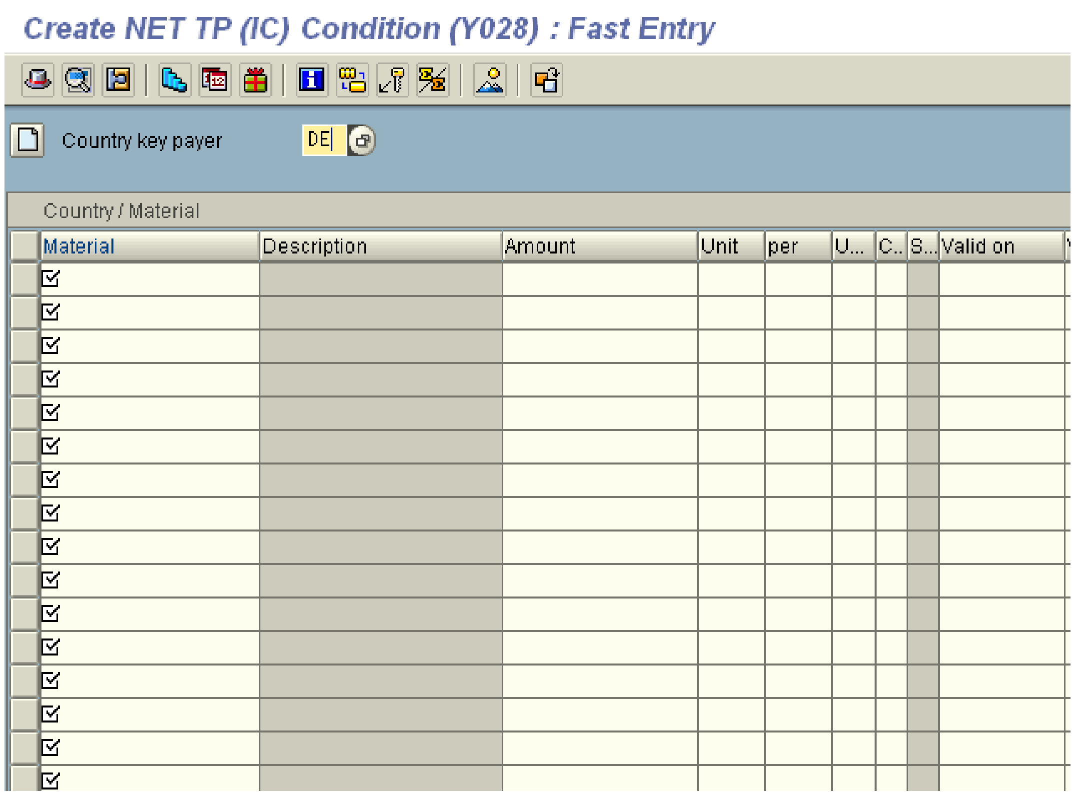


Figure 13: Create Net TP –transaction

This documentation will be used in explaining the issue with licence key items to the IT department. The objective is that the issue will be solved before the Motorola items are transferred into the system. It is important to also prepare system for the acquisition and ensure that there are no open issues, because it is possible that the effects of the acquisition will cause new open issues.

6.5 Global transfer price level maintenance

Each country that Nokia Siemens Networks operates in has its own pricelist, which contains all orderable sales items. The local country controllers are responsible for monitoring their own pricelists with the global team. Transfer prices should be set so that the legal company reaches an operating profit, which is in line with Nokia Siemens Networks Transfer Pricing policy (for the sale of services and equipment as a whole). Along with the Arms Length Principle the local rules defined for the specific legal entity have to be taken into account. If the operating profit of a specific country shows surplus the transfer prices have to be increased or the other way around if the operating profit is too high (in Local Sales mode). In these cases the country controller then selects specific GICs, which have to be decreased or increased. Next the controller calculates the percentage how much the GICs have to be increased or decreased to get the operating profit in line. The Transfer pricing team then executes the change in percents to the GICs selected by the country controller. Occasionally the TP team also changes the prices of individual items if the transfer price is tolerably high, but on most cases the request are on GIC level.

The procedure explained in last chapter is an ideal for how the whole process should be handled. Unfortunately, some country controllers and global teams do not focus their attention enough on this matter. The Transfer pricing team is responsible for monitoring that the transfer pricing policy is followed in each legal entity of NSN. However, as mentioned earlier the TP team requires approval from the country controller to execute the price changes. The approval mail also includes the directions instructing how the prices should be changed. The problem is that some country controllers are not active enough regarding this matter. If the country controller does not monitor the pricelist, the TP team then has to use part of the work time to send reminders to the controller. If the prices have not been changed before periodical or quarterly reporting the TP team has to issue additional debit or credit notes to adjust the operating profit on a correct level. In addition, the legislation in some counties forbids the issuing of credit or debit notes. In these counties in particular it is essential that the prices are adjusted before reporting periods.

This issue is solely inside the finance department and does not require effort from other departments. New training sessions have to be arranged and information flow has to be encouraged between colleagues. In the past the training sessions were arranged by flying a large quantity of people to a certain country for a conference. Nowadays, travelling has been limited to minimum to save funds. The sessions are arranged by using Cisco Webex Internet Conference program for the hosting of Power Point presentations. Voice is transmitted by using conference call equipment. By using these tools it is possible to arrange training sessions, which include all the country controllers and appropriate people from the global teams. The conference should be solely focused on transfer price controlling. Naturally there have been similar kind of training sessions in the past, but the focus has not been in transfer pricing matters. Often there are too many topics included in an individual training session, which makes it hard to adopt all the information. A training sessions arranged only for transfer pricing matters would be an ideal way of providing the necessary information in clear and convenient way. These training sessions would also highlight the importance of proper transfer price level maintenance.

Communication among colleagues should also be encouraged. Exchange of information between colleagues in different countries is a positive aspect. For this reason it is possible to take the development of communication even further. Currently new employees in NSN have a personal "buddy" colleague selected for them to help the new person get accustomed to work and premises in NSN. In a similar way country controllers and personnel in global team could have a buddy selected for them. The selection should be done by taking into account the sales mode and local rules applied in the country. For example, it would be logical to appoint personnel from Argentina and Brazil as buddies for similar legislation and sales mode. Buddies could turn to each other in difficult and uncertain situations.

Also general tasks and responsibilities in daily work should be taken into consideration when selecting appropriate buddy-colleagues for personnel. This way both persons could share and discuss work related subjects and find solutions to pending issues. Usually it is easier to appoint questions informally to a friend colleague instead of contacting a separate team for solution. A buddy colleague would be there to help if the solution cannot be found inside the global team. The assistance from a buddy-colleague would be extremely valuable to a new country controller who requires assistance in the first few months of work, especially now when the Motorola acquisition is in the closing stages.

If the transfer price level is not maintained according to the regulations and sales mode specified on a country specific scale negative impacts will occur. The Transfer Pricing team has to issue credit and debit notes usually at the last minute before certain quarter or period is closing to avoid faulty figures in financial reporting. The most significant issue caused by an inaccurate transfer price level is that if the prices are set too high Nokia Siemens Networks pays higher customs duties and taxes to the target country than necessary. Logically the other way around if the prices are set too low the tax officials might get suspicious and issue an additional tax for Nokia Siemens Networks. For these severe causes this issue has to be taken seriously and every effort should be made to emphasize the importance of the price maintenance in arranged trainings and encourage the flow of information between colleagues.

6.6 Summary of the development suggestions

The following diagram summarizes the development suggestions introduced in this thesis.

Type	Capacity issues in SAP	Licence key items	Maintenance of the correct TP-level
Effects	Delayed orders for customers Unable to process new pricelists	Additional credit/debit notes Problems with customs officials	Incorrect figures in reporting Additional taxes or customs
Suggestions	GIC/sales item simplification Request for additional capacity	Update on transaction Revision of the current sales items	Training sessions Buddy-colleagues

Diagram 1 : The Development Suggestions

The development suggestions introduced in this thesis provide a solution for improving the current flaws in the system. These suggestions help the company to prepare for the challenges caused by the upcoming Motorola acquisition. The upcoming challenges includes implementation of 30 000 sales items to NSN systems from Motorola.

The addition of more server capacity in SAP R3 will ensure fully functional transfer price creation process even during the busiest reporting periods. Similarly, the logistics can handle all deliveries during these busy times and the end customers receive the ordered goods in time. If the IT department is able to process a transaction that automatically changes new licence key items to 0.01 in local currency, a reasonable time is saved from the Transfer Pricing team. The adjustment to 0.01 in local currencies prevents unnecessary issuing of credit/debit notes and problems with customs officials and saves time used for the order cancellation process. The adjustment will also prevent issues with local customs officials when the goods are not delivered to the destination country with faulty prices.

The suggested new training sessions for country controllers will significantly develop the local transfer price level controlling. The teams along with the country controller will be more prepared to follow the periodical changes in the operating profit of the specific legal entity and request the appropriate actions from the transfer pricing team. The training sessions will also emphasize the importance of the correct transfer price level maintenance by notifying the teams of the effects caused by the incorrect transfer price level. Transfer prices that are not in line with the regulations defined to the destination country along with the current operating profit causes Nokia Siemens Networks to pay higher customs duties and taxes than necessary and involves problems with the local authorities.

The buddy-colleague suggestion will increase the flow of information between the personnel of NSN and spare time from the Transfer Pricing team for not having to explain the basic facts. Country controllers and global teams in various countries can share and discuss the different methods they use for calculating the correct transfer price level and learn from each other.

7 Conclusion

The objective of the thesis was to provide detailed suggestions for Nokia Siemens Networks for developing the Transfer Pricing Process. For the consistency of the thesis it was necessary to include theory related to the International Financial Reporting Standards, the tax legislation in Finland and different transfer pricing methods. The objective of the theoretical section was to provide information for a reader who is not familiar with the subject of transfer pricing. It was also necessary to introduce transfer pricing methods to understand different sales modes in NSN. The Transfer Pricing Process includes the creation process of new transfer prices in SAP R3 environment, general transfer price maintenance and other responsibilities of the Transfer Pricing team. The commission was given at this time, because it is essential that the issues have been solved before the effects of the Motorola acquisition will take place. The Motorola acquisition will transfer approximately 30 000 new sales items in SAP R3 environment and increase the challenge of maintaining the correct transfer price level globally.

The development criteria were agreed together with the team. The objective was that the suggestions are possible to be made by using the acquired work experience and Transfer Pricing Instructions as an aid in the process. Working on a part time basis for Nokia Siemens Networks provided an excellent opportunity to access the NSN intranet and use the office premises for writing this thesis. Working in the Transfer Pricing team from 2008-2011 ensured a proper understanding of all the work related processes to evaluate the flaws in the systems and provide detailed suggestions for developing the daily work of the team, which reflects to the whole entity. The flaws which were introduced in this thesis were selected according to their importance for Transfer Pricing team and for financial reporting in general.

Now that the flaws were defined and agreed together with the team the next process was to find an appropriate method for documenting the flaws in detail. This stage involved research relating to how previous cases were solved. The outcome showed that previously the issues

relating to the development of SAP related transactions required a creation of a ticket. This ticket is assigned to the Information Technology department which seeks solutions for developing tools used by the personnel of NSN. The ticket is required to contain detailed documentation of the program malfunctioning. Therefore screenshots from SAP transactions were included in this thesis along with details in text form to aid the IT personnel to be able to develop the transactions in question. When the ticket has been created persons from the IT department are assigned to work with the case. Once the ticket has been processed the IT person will ask the creator of the ticket to determine if the issue has been solved. The creator of the ticket will then test if the documented flaw has been corrected.
The development of the selected criteria became essential in the current situation. Nokia Siemens Networks and Motorola Inc. agreed that Nokia Siemens Networks will acquire the majority of Motorola's wireless network infrastructure assets. This acquisition will transfer 30 000 new sales items in the system. Therefore it was necessary to prepare the system for the effects of the acquisition.

The development criteria related to capacity and licence key items in SAP R3 environment is currently processed by the IT department. Ticket has been created by the transfer pricing team and the requested transactions are currently in development. The documentation in this thesis was used for the creation of the tickets to provide detailed information about the transactions requested for developed. It was awarding to notice that the outcome of the thesis was used for a real purpose and that the outcome was beneficial for Nokia Siemens Networks.

The Transfer Pricing team has also created more detailed instructions to country controllers related to maintaining the transfer prices on a correct level. These instructions also take in account also the effects of the Motorola acquisition. Training sessions will be also arranged for country controllers and personnel in the global teams, which also include the transfer pricing maintenance instructions. The buddy-colleague system mentioned in this thesis will be also taken into consideration and is likely to be launched in June.

As a whole the creation of this thesis has been challenging and rewarding at the same time. The objective was to provide detailed suggestions for developing the transfer pricing procedure. Taking into account the current actions done by the Transfer Pricing team for developing the flaws in the system by using this thesis as an aid in the process, the objective of the thesis can be considered to be properly fulfilled.

The development suggestions introduced in this thesis are related to the current issues in the system. In the future it is possible to conduct even a larger scale of research by focusing attention on the whole transfer pricing policy. As suggested by many experts, the applied transfer pricing policy should be evaluated on a timely basis by taking on account the current situation of the company. It is essential that the applied transfer pricing policy is beneficial to the company.

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Figures

Diagrams

Appendix

Press Release
Espoo, Finland / Schaumburg, Illinois – July 19, 2010

Nokia Siemens Networks to Acquire Certain Wireless Network Infrastructure Assets of Motorola for US $1.2 Billion

- **Transaction expected to significantly strengthen Nokia Siemens Networks' presence globally, particularly in the United States and Japan.**
- **Nokia Siemens Networks targeting to gain incumbent relationships with more than 50 operators and strengthen relationships with others.**
- **Acquisition to enhance position of Nokia Siemens Networks in key wireless technologies; will give company large global footprint in CDMA.**
- **Motorola retains the iDEN business, substantially all the patents related to its wireless network infrastructure business, and other selected assets.**
- **The companies expect to complete closing activities by the end of 2010.**

Nokia Siemens Networks and Motorola, Inc. (NYSE: MOT) today jointly announced that the companies have entered into an agreement under which Nokia Siemens Networks will acquire the majority of Motorola's wireless network infrastructure assets for US $1.2 billion in cash. The companies expect to complete closing activities by the end of 2010, subject to customary closing conditions including regulatory approvals.

"This is an exciting acquisition that I believe has significant benefits for customers, employees and our shareholders," said Rajeev Suri, chief executive officer of Nokia Siemens Networks. "Motorola's current customers will continue to get world-class support for their installed base and a clear path for transitioning to next generation technologies while employees will join an industry leader with global scale and reach. Nokia Siemens Networks will see the benefits of a deal that is expected to enhance profitability and cash-flow and to have significant upside potential."

"Motorola is very proud of the operational and financial performance of our Networks business and its employees, who will now become a valuable addition to Nokia Siemens Networks. We are excited to have reached this agreement to combine our Networks team with such an industry leader," said Greg Brown, Co-CEO of Motorola. "This is great news for our customers, our investors and our people and will allow us to sharpen our strategic focus on providing mission and business critical solutions for our government, public safety, and enterprise customers."

As part of the transaction, Nokia Siemens Networks expects to gain incumbent relationships with more than 50 operators and to strengthen its position with China Mobile, Clearwire, KDDI, Sprint, Verizon Wireless and Vodafone.

Appendix 1: Motorola acquisition press release